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Section on the Economy of the USSR

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for

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THE SOVIET ECONOMY

I now would like to discuss the economy of the Soviet Union, concentrating on developments in 1966 and 1967 and on the economic implications of higher defense spending.

I. During the past 2 years the Soviet economy picked up a little momentum following the slowdown of the preceding 5 years. Gross national product increased more than 6 percent annually during 1966-67 compared with a little under 5 percent in 1961-65. Even so, however, the Soviet economy has not regained the high growth rates it had during the 1950's.

(CHART, RATES OF GROWTH OF GNP, INDUSTRY AND AGRICULTURE).

- A. The higher growth of the past 2 years was due in large part to luck with the weather.
1. In 1966 the USSR harvested the largest grain crop in its history, and a slightly better than average crop also was harvested in 1967.

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2. Net agricultural output in these 2 years increased an average of $4\frac{1}{2}$ percent annually, compared with a 3 percent annual gain over the preceding 5 years.
 3. Greatly increased supplies of fertilizer plus higher prices paid to farmers also contributed to this surge in output, although above-average weather was the most important factor.
- B. The rate of growth of industrial production picked up moderately in 1966-67. It averaged about 8 percent compared with $6\frac{1}{2}$ percent in 1961-65 but is still far below the $9\frac{1}{2}$ percent rate of the 1950's.
1. A substantial part of industry's higher growth in 1966-67 was due to the larger supplies of agricultural raw materials that resulted from the good crops.
 2. Also important was the fact that many of the plants hastily built and commissioned under Khrushchev's regime finally started producing up to capacity.
 3. The economic reform that the Soviets are now carrying out also may have had a small beneficial effect on industrial output in 1967.

II. Soviet GNP grew faster than US GNP in 1966-67. Nevertheless the Soviet economy is still less than half the size of the US economy, and the absolute gap between our GNP and theirs continues to widen.

(CHART, US AND SOVIET GROSS NATIONAL PRODUCT).

A. As you may know, they allocate their total output differently from the way we do. Their allocations stress the elements of national power.

1. In dollar values, Soviet spending for defense and for investment is about four-fifths of ours.
2. When it comes to consumption, a Soviet population that is almost one-fifth larger than ours gets only about one-third of what is spent for consumption here.

III. The USSR made some significant changes in the allocation of its total output in 1966-67.

(CHART, RATES OF GROWTH OF CONSUMPTION, DEFENSE AND INVESTMENT).

A. A larger share of GNP went to the marshals. Defense expenditures rose 8 percent annually in these 2 years, 4 times as fast as in the preceding 5 years.

1. Spending for advanced weapons and space systems and especially for research and development is growing 2 or 3 times as fast as total defense outlays.

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2. This creates a severe drag on the whole economy.

These programs siphon off the most highly skilled engineers and scientists. They have first call on scarce strategic materials, sophisticated electronics and the most advanced industrial processes. These are the very kind of resources that the rest of the economy needs to modernize and to assure rapid technological development.

- B. Consumers fared much better than before.

1. An important reason was the improvement in agriculture.
2. Another reason was that the Soviet leadership wanted to make a good showing in the 50th Anniversary Year. The regime even used its scarce hard currency to import an unprecedented \$100 million in clothing from the West in 1967.

- C. Investment in industry and agriculture was slighted.

1. The rate of growth of investment in industry dropped by one-third from the already low rates of 1961-65.
2. Investment in agriculture also grew much more slowly than in the earlier period. Indeed, the rate was only half that scheduled in Brezhnev's mammoth program to get agriculture out of the doldrums.

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D. This diversion of resources away from investment shows up especially clearly when we compare the growth rates of machinery production with those for weapons production.

(CHART, PRODUCTION OF MACHINERY AND WEAPONS).

1. In 1966-67 production of weapons increased $1\frac{1}{2}$ times as fast as production of machinery and equipment for civilian purposes.

E. So for the moment at least investment, the key to future growth of the economy, clearly has yielded priority to the marshals and to consumers.

IV. Recent Soviet announcements suggest that these general policies will continue.

A. The Soviets announced a 15 percent increase in the defense budget for 1968 and an 11 percent increase in the budget for science, which includes substantial amounts of military R and D expenditures.

1. A part of this increase reflect price increases and accounting changes.
2. The defense budget does not cover all outlays for defense and space.
3. Nevertheless, a substantial increase in defense programs is likely in 1968.

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- B. Some of the 1970 goals for important civilian industries have been cut back.
1. Production targets for gas and electric power have been reduced by 4 to 8 percent; for plastics and chemical fibers they have been cut even more.
 2. On the other hand the goal for steel production -- a military-related sector -- is about the same as it was, and this sector is to get a whopping 23 percent increase in investment in 1968.
- C. Although the data are very meager indeed, investment in industry and agriculture may not grow any faster in 1968-70 than it did in 1966-67.
- D. Consumers have been promised continued big gains in 1968-70.
1. Large increases in minimum wages and other welfare programs are to take effect in 1968.
 2. Per capita real income is to go up by 7 percent in 1968.
 3. Goals for large increases in production of automobiles, television sets, refrigerators and other consumer durables have been retained.
 4. Not all of these golden promises are likely to be fulfilled.

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5. We should note, however, that even if they are carried out, the lot of the Soviet consumer will still not be enviable by Western standards.
- a. Only a trickle of automobiles will be made available for private use. Even if 1970 goals are met, the USSR will have only half as many automobiles per capita as Greece does now. A Czech or an East German now has a better chance of owning a car than does a Soviet citizen.
 - b. The average citizen will continue to live in cramped and crowded quarters. Per capita housing space won't even have reached the level that the Soviets themselves have set as the minimum for health and decency.
 - c. Availabilities of such things as television sets and refrigerators still will be below those in the US and Western Europe.
 - d. His diet will still be loaded with bread and potatoes instead of the meat and dairy products he would like.
 - e. Queues and shoddy goods still will be a daily trial and tribulation.

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V. By favoring defense and being niggardly with investment the Soviets are risking another slowdown in economic growth like that of the early 1960's. If these priorities continue:

- A. Expansion and modernization of the industrial plant will have to slow down. The overall technological level of Soviet industry will lag even farther behind the West than it already does.
- B. Agriculture will not be getting as much machinery, quality fertilizer and funds for land improvement as it needs. This will make future growth in output more precarious.
 - 1. You will recall that in 1963-65 poor harvests forced the USSR to spend over 1.5 billion of its scarce gold reserves to import wheat.
 - 2. Agriculture will remain grossly inefficient in comparison with Western countries. It now uses more than a third of the total labor force.
- C. Consumers may not get the goods and services to match the money income gains they have been promised.
 - 1. Cutbacks in investment in industry mean that ultimately production of consumer goods will be affected.
 - 2. Cutbacks in investment allocations to agriculture jeopardizes the chances for gains in supplies of quality foods like meat and milk.

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D. Looking ahead only over the next 3 years, that is, to 1970, which is the last year of the current 5-year plan, we think that the overall growth of GNP is likely to fall back somewhat from the 6 percent achieved in 1966-67, perhaps to around 5- $\frac{1}{2}$ percent.

1. A critical factor will be the weather for agriculture.

Exceptional weather cannot be counted on to produce good harvests every year.

2. The growth of industrial production may hold up for a while. An important factor here will be the impact of the economic reform. Initially it seems to be having a temporary beneficial impact on productivity. The reforms are not very far-reaching, however, and in our judgment they will not cure the long-standing ills of the Soviet system of economic management.

3. Ultimately, however, the cutback in investment is bound to affect economic growth adversely. Some of the Soviet leaders already recognize this.

Indeed, how best to allocate the USSR's limited resources seems to be a hot issue in the Kremlin at the moment.

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VI. The USSR's foreign trade continued to increase in 1966-67 and its hard currency position improved considerably.

(CHART, SOVIET FOREIGN TRADE).

- A. About two-thirds of Soviet foreign trade is with Communist countries and one-third with the Free World.
1. Since 1960 trade with Western industrialized countries has increased rapidly as the USSR has sought to upgrade the quality of its industrial plant by importing equipment and technology.
 2. The growth of trade with the less developed countries has been erratic and has depended largely on Soviet willingness to extend aid.
 3. The USSR's trade with China continued to decline sharply in both 1966 and 1967, when it was a mere \$250 million, compared with over \$2 billion in 1959.
- B. The USSR's hard currency position improved in 1966-67 and its gold reserves rose.
1. Because of chronic difficulties in finding products that Western countries will buy, the USSR has long had a hard currency deficit with the West. To pay for the imports it so much needed the USSR has had to sell gold and also seek credits. In

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1966-67 it had better success in expanding exports and checking imports, and its hard currency deficit dropped to less than \$100 million.

2. In 1963-65 the USSR was forced to sell large amounts of gold to pay for emergency imports of wheat and also for machinery. As a result its gold reserve dropped from over \$2 billion in 1962 to about \$1 billion in 1965.

(CHART, SOVIET GOLD RESERVES)

3. The USSR sold almost no gold in 1966-67 and gold reserves are now up to a little over \$1.2 billion.
4. The USSR now produces about \$200 million in gold each year. Despite very high production costs the Soviets are now carrying out a program of expanding the industry at about 7 percent annually.

VII. There are as yet no signs that the preoccupation with resource allocation problems at home is leading the Soviets to curtail the program of economic and military aid to Free World countries.

(CHART, SOVIET FOREIGN AID ACTIVITY IN THE FREE WORLD)

- A. In 1966 the USSR extended a record \$ 1.3 billion in economic aid. Over \$500 million of this represented

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a commitment to support India's 5-year plan. Large credits were also granted to Iran, Syria, and Brazil.

B. Extensions of economic aid dropped sharply in 1967.

1. This dramatic fall apparently represents a lack of suitable opportunities rather than a change in policy.

C. However, the Soviets do seem to be getting a bit tougher with their aid.

1. They are being more selective with the kinds of projects undertaken, so as to ensure a greater degree of success.
2. Terms of the credits/becoming more trade-oriented and often are harder -- 5-10 years for repayment instead of the customary 12 and an interest rate of $3-3\frac{1}{2}$ percent instead of $2\frac{1}{2}$ percent. Occasionally down payments are required, and repayments sometimes must be made partly in hard currency.

D. There was no dramatic change in the level of military aid in 1966-67.

1. More than half of the aid extended in 1966 is accounted for by an important new agreement with Iraq -- the fifth and largest one to date. The

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USSR also committed itself to supply India with \$100 million in fighter bombers and trainers.

8. In 1967, following the Arab-Israeli war in June, the USSR concluded new arms agreements with Iraq, Syria and the UAR. The amounts ranged from \$25 to \$100 million. Earlier in the year an arms agreement was signed with Iran, the first one Iran had signed with a Communist country. Agreements also were concluded with Nigeria and Yemen, and military goods were airlifted to these countries.

E. Actual deliveries of military equipment were a little higher in 1966-67 than in earlier years.

1. In June-July 1967 the USSR airlifted large quantities of jet fighters and possibly some anti-aircraft guns to the Arabs after their defeat by the Israelis. The pace of deliveries has now slowed to near pre-war levels.
2. We estimate that the USSR has replaced at least half of the half a billion dollars of military equipment that the Arabs lost in the war. We expect the flow of aid to continue.

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Graphics for Inclusion in
DCI Briefing Package

1. Rates of Growth of GNP, Industry and Agriculture
2. US and Soviet Gross National Product
3. Rates of Growth of Consumption, Defense and Investment
4. Production of Machinery and Weapons
5. Soviet Foreign Trade
6. Soviet Gold Reserves
7. Soviet Foreign Aid Activity in the Free World

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